



TIAA-CREF Response to Request for Information for California Secure Choice

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Financial Services

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Introduction

TIAA-CREF® has served higher education, healthcare, research, government and other nonprofit employers since 1918, fulfilling a mission to help employees in these fields achieve lifetime retirement security through high-quality, efficient products and services. TIAA, and its companion organization, CREF, are governed by charters that direct each entity to operate on a not-for-profit basis, and which limits the offer of its products and services to eligible employees of eligible (i.e., nonprofit) employers.

We are pleased to offer the following response to this Request for Information for the California Secure Choice program, and hope our retirement planning expertise helps the state as it considers additional ways to provide retirement security to more Californians.

Plan Structure

- 1. What type of plan structure would you recommend to best meet the statutory goals and objectives for the Program, which include simplicity, ease of administration for employers, preservation of principal and portability of benefits (e.g., a pooled fund with guaranteed interest credited to individual accounts on a regular basis that utilizes a gain and loss reserve? Individually held IRA-type accounts with a variety of funds from which participants could choose? Something else altogether?)**

California Secure Choice (CSC) will seek to help a broad spectrum of Californians achieve retirement security. To do this it must offer the appropriate mix of flexibility and structure to serve the greatest number of participants possible, and do so in the most efficient way possible. These attributes are not contradictory if properly positioned with the end goal in mind.

Flexibility for the program should be focused in the area of portability, to attract the most participants possible by convincing them that CSC can meet their needs regardless of where they work in the future. Since CSC should not seek to be viewed in the same light as other investment accounts, but rather as a foundational contributor to long-term financial security, a straightforward investment structure with limited options that are easy to understand will position CSC appropriately.

We believe California has a unique opportunity to establish a structure separate from the limits of current retirement savings offerings. Assuming California can work with federal agencies and Congress if need be to receive exemptions from retirement plan provisions and restrictions under Federal law, such as the Internal Revenue Code, and the Employee Retirement Income Security Act of 1974 (ERISA), we recommend a group plan sponsored by the State with individual accounts, similar to a 529 college savings plan. Contributions to CSC would be made via payroll reductions by employers and remitted through California's tax withholding system, such as the Economic Development Department (EDD). The appropriate state agency could then forward contributions to the company managing the program.

This approach offers the most cost efficient structure because it:

- Eliminates paper and individual remittances;
- Utilizes an existing remittance structure—the tax collection system—rather than creating a new one;

- Creates an automatic, regular savings “habit”.

Moreover, this approach retains CSC’s accessibility to individuals who have limited banking options.

Investment Options

2. What investments would you recommend to best meet the goals and objectives of the Program, both in terms of the types of funds and underlying assets, and the style of management (i.e., active vs. passive)?

We recommend an investment menu with limited options to achieve the greatest efficiency possible. We have three recommended investment choices:

- A long-term guaranteed account, similar to our TIAA Traditional Account, would be ideal for CSC, because it offers a guarantee of both principal and a declared rate of interest backed by an insurance company with the highest available financial strength ratings. All guarantees are subject to TIAA’s claims paying ability. This account would invest in bonds, direct loans to business and industry, and real estate, providing broad coverage of a variety of investment sectors.
- An equity fund that covers a broad cross-section of the equity markets, including domestic and international stocks, and utilizing both passive and actively managed components.
- A managed allocation account, utilizing the two investments listed above, that adjusts the mix of exposure to fixed and equity investments based on the participant’s years to retirement.

While it is widely accepted that some exposure to equities over the long term can offer growth potential to offset inflation, we believe that the CSC must appeal to a broad group, some of whom may not trust investing in stocks. The long-term guaranteed account would possess the benefit of being easy to understand, with its guarantee of principal and a declared interest rate.

Since an efficient, low-cost program that facilitates greater retirement security is a primary goal for CSC, it should avoid offering too many equity options, because they would require significant customer support around issues like suitability and ramping up communication requirements. To achieve both efficiency and performance, the broad equity fund would utilize indexing to provide a broad investment base across sectors, while actively managing the remainder of the fund to produce incremental return.

Finally, the automatic, managed allocation option would provide participants with exposure to the broad investment market while automatically rebalancing their exposure to sectors as they approach retirement.

3. If you recommend more than one investment option, what would you recommend as the “default,” or automatic, option that would be chosen for participants who do not make an affirmative decision?

We believe that some research should be made before selecting the program's default option for those participants not making a specific election. There are three possible approaches, each with its own advantages. Because CSC would require an affirmative decision by employees to not participate, there will be many participants who will enter the program “unknowingly”. The long-term guaranteed fixed account may be appropriate since there is no risk of loss of principal and it is easier for participants to understand. (And unlike a money market account, this account is invested for the long term.)

Managed allocation options are increasingly the preferred default vehicle, given their automatic rebalancing features. However, this option may add expense to the program that conflicts with CSC's goal of high efficiency. A lower-cost default that offers broad coverage to all sectors of the investment marketplace would be a 50/50 allocation between the guaranteed account and the broad-based equity fund.

4. Would you recommend including any insured interest or insured income products? Why or why not? What are the advantages and disadvantages of these products in terms of performance, risks, cost and transparency?

As noted above, we believe a guaranteed account backed by a financially stable insurance company provides tremendous advantages to the program. The primary advantage is the combination of long term performance combined with a guarantee of principal and a contractual rate of return. This will be an easy concept for participants in CSC to understand, and since the program is designed for long-term accumulation, restrictions on liquidity should not be a major concern. For the State as CSC's sponsor, this account is more complex and less transparent than a market-valued account, but there are clear disclosures available that should mitigate these concerns.

Due to TIAA's charter, there are restrictions on offering TIAA products, such as our TIAA Traditional Account to a broad population like the population that CSC is expected to serve. However, we believe it is illustrative to understand how that account works, since a similar approach could be utilized for CSC. TIAA has offered the TIAA Traditional Account to its higher education clients for 95 years. The guaranteed minimum interest crediting rate for the TIAA Traditional Annuity under the Retirement Choice Contract in the accumulation stage is established each calendar year and is applicable to amounts received in that calendar year. Such guaranteed rate will apply to the contributions attributable to that initial calendar year for 10 years. In year 11, a new guaranteed rate will be established for those amounts. The end result will be year one and year 11 contributions receiving the same guaranteed interest rate in year 11 and beyond. The guaranteed rate floats between 1% and 3% based on the five-year Constant Maturity Treasury Rate, less 125 basis points. The current minimum guarantee under Retirement Choice contracts is 1.00%.

Most importantly, this guaranteed account is not designed to be a short term parking place for funds, but rather, a long term retirement accumulation vehicle with returns resulting from longer term investments. This accumulation is then intended to be annuitized to provide participants some level of guaranteed, lifetime income.

5. Would you recommend the Program provide a lifelong stream of guaranteed income? If so, how would you convert retirement savings into a lifelong retirement income stream, and what investment product would you recommend to accomplish this objective?

Because CSC is designed to help Californians achieve greater security in retirement, we absolutely recommend that a lifetime income payout should not only be available but encouraged.

To support this goal, using a low-cost annuity product such those used in the TIAA-CREF system in the accumulation phase offers one of the best ways to successfully transition to a lifetime payout.

Our long experience shows that amounts accumulated in annuity products are significantly more likely to convert to a lifetime income rather than “leaking out” through cash withdrawals. At time of distribution, the annuity accumulation account can easily be converted to an annuity payout with a simple election by the participant.

6. Would your recommendations require changes to the investment policy parameters in SB 1234? If so, what modifications to the statute would you recommend, and why?

Our recommendations fall within the investment policy parameters of SB 1234.

7. What recommendations would you make to ensure an effective risk management system is in place to monitor risk levels of the Program and ensure risks taken are prudent and properly managed?

For providers of services to CSC, the State should require a disclosure from each vendor that provides details on their risk management program, covering risks in financial, investment, operational, and legal/regulatory areas. In turn, the State should create a clear policy that sets structures for review of Program performance on multiple fronts, with strong oversight of the performance of providers. The Board could even bring independent ratings agencies into the process to assist in risk management oversight.

We recommend that a majority of members of the CSC Board bring financial and/or insurance industry expertise to the Board.

Plan Design and Features

8. What would you recommend as the automatic, or “default” contribution level?

One of CSC’s challenges is to create a program that is accessible to many, yet starts them on a path to real retirement security. One pitfall to avoid is creating the mistaken impression that minimal participation assures that retirement security.

We think the best way to meet these dual challenges is to establish a default contribution of 3%, which would constitute a solid base to build upon while keeping the program affordable to participants at the start.

However, this should be paired with an automatic contribution increase program, in which that contribution increases by .5%-1% every year automatically, unless a participant “opts out”. Over time, this will create a significant funding base toward retirement security.

CSC will provide participants with a good base toward achieving real retirement security, but additional savings beyond 3% will be important. In our long experience in helping individuals save for retirement, it has become clear that income replacement of 60%-80% is necessary to attain financial security. Even for individuals covered by Social Security, contributions of 12% of earnings for 30 years are necessary to generate a total income replacement of 70% (including Social Security benefits).

CSC will be a great way to initiate workers into the habit of saving for their retirement, and a 3% contribution is a great start—but our goal should be to view it as a base to build upon.

9. What options, if any, would you recommend for an automatic escalation feature that increases participants’ contributions over time?

As noted above, we would recommend an annual automatic increase of .5% or 1% unless the participant makes an election to “opt out” of such an increase.

10. Are there any other plan design features that should be included (or eliminated) to ensure the plan meets the goals and objectives of the Program? Please explain.

As stated in the Investments section, we recommend very limited options at the launch of CSC, to ensure the program launches as efficiently as possible and with minimal complexity, so that it is accessible to the widest cross section of individuals. As it becomes established and grows, CSC could carefully introduce additional investment options, recognizing that doing so would necessitate the implementation of additional features like investment advice models, etc. We recommend that before moving down this path, which can add to the expense of the program, CSC’s penetration and growth must be assessed.

11. What plan design elements would you recommend to minimize pre-retirement “leakage?”

One of the primary causes of pre-retirement “leakage” is the presence of loans in retirement programs. We recommend that CSC not include them as a program feature. As stated above, we think utilizing a low-cost annuity account in the accumulation phase can also help prevent leakage, by representing a participant’s participation in CSC as an accumulating income benefit rather than as an accumulation of a lump sum cash amount.

In this regard, CSC can share an attribute of both defined benefit plans and properly-designed, risk-managed defined contribution retirement plans that either limit or do not allow loans. These plans have been more effective at helping participants achieve lifetime retirement security than many 401(k) plans, which experience greater leakage through loans and the promotion of a cash accumulation mindset.

Costs and Fees

12. Provide an estimate of the ongoing administrative costs and fees of the investment options you recommend and identify the components of those costs and fees.

The actual administrative pricing of any option we offer varies based on the size and terms of the program in which they are used. However, TIAA-CREF's annuities are among the lowest cost in the industry, with fees under 1% and often significantly lower. Typically, the fees for investment management of any product is one of the smallest components of the total cost, falling in the 10-20 basis point range. Record keeping, distribution, and communications/customer service are much more variable price drivers and can easily add 100 to 200 basis points (1%-2%) in additional fees.

CSC will need to carefully consider how these costs are factored and implemented as greater fees will diminish lifetime savings negatively impact the Program's overall efficiencies in these areas.

13. How would you propose to assess fees to cover the costs required to start up the plan? Please identify the components of those costs and fees.

This will depend greatly on the ultimate structure of CSC. Even a very straightforward, efficiently-designed program will be challenged to amortize the costs of launching what will essentially be a ground breaking new plan.

We would anticipate that both the State and any private providers involved in CSC would incur costs in a number of broad areas, including but not limited to:

- Establishing a compliant legal structure
- Developing connectivity for remittances and reporting with employers
- Establishing communications outreaches and a transactional internet presence
- Creation of recordkeeping systems that can accommodate the new program
- Promoting CSC to Californians and their employers

While the State would make an investment to create the Program, it can also expect that if designed properly, there will be interest from private providers to administer CSC, and that such providers will also invest resources to launch the Program if they believe that over time there will be a return on that investment. Typically, fees are charged in basis points of assets under management, though per account fees may also be assessed. (It should be noted that per account fees—for example, \$25 per year—can be significant relative to the size of some accounts.)

The State will need to be cognizant about CSC's plan economics. Because most costs to financial services providers are fixed, regardless of account size, small accounts are more expensive in basis points terms. While the long term potential of CSC is great, if it wishes to provide low cost pricing to participants, it will need to partner with a provider utilizing a long term outlook to allow for a recouping of start up costs.

14. How would you recommend the Board ensure transparency of fee and expense information available to the Board and Secure Choice participants including transparency of service providers' relationships or potential conflicts that may increase costs and/or conflict with the interests of plan participants?

The Board should establish straightforward disclosure requirements that the Program provider can fulfill on a regular (e.g., annual) basis. This should include plan financials, business relationships, and the disclosure typically required by FINRA and other regulators.

Administrative Issues

15. What are your recommendations for identifying, and disseminating information to, eligible employers and employees (including employees of nonparticipating employers)? Consider the potential roles that could be played by California's Employment Development Department, any other state agencies or departments, and/or private sector vendors.

To establish and sustain success for CSC, a strong partnership must be established between State agencies and private vendors to the program.

We recommend an aggressive public relations and promotional campaign, with the Employment Development Department coordinating the efforts of state agencies and private vendors. Utilizing the connections that already exist for the collection of taxes (through the Franchise Tax Board) can assure broad coverage.

CSC should be positioned as a tremendous opportunity to strengthen the employment infrastructure of California by helping its workers achieve retirement security. This goal should appeal to multiple stakeholders in the state, and outreach through both unions and business organizations such as the California Chamber of Commerce should be a key goal.

16. What are your recommendations for managing enrollment, the receipt and recordkeeping of employee payroll contributions and transactions, and managing rollovers in and out of Program accounts, including potential roles for the Employment Development Department, any other state agencies or departments, and/or private sector vendors?

Two key goals for CSC—broad outreach in the most efficient manner possible—call for utilizing existing structures wherever possible in administering the Program. We recommend that contributions and other transactions through employers be made through the tax collection system already in place in California. The Employment Development Department would coordinate administration on the state's end, and interface with the private provider of program management for CSC. Once contributions and supporting data have been sent to the plan provider, it would handle all other records management and transactions for the Program. CSC participants would interact with the provider to request information, payouts, etc.

17. Do you have any particular concerns about, or anticipate any significant challenges with, administering the Program? If so, how would those concerns and challenges best be addressed?

Our greatest concern in administering an anticipated program like CSC is also what excites us – its size and scope and its ability to fundamentally contribute to the retirement security of so many. As noted earlier, due to the expected number of small accounts that will understandably be a part of this program, the economics of CSC will be challenging. It is probably unrealistic to expect that it can operate like many traditional retirement programs administered by TIAA-CREF. The program must be designed and implemented with a constant eye toward efficiency, managing the natural inclination to add on features that might be “nice to have” but not “must have”. Accordingly, we would need to develop a very clear understanding and frank relationship with the State as sponsor, so that we might extract the maximum value from infrastructure that already exists in California.

Legal Issues

18. What approach would you recommend to demonstrate the Program is not subject to ERISA and that Secure Choice accounts would qualify for favorable federal income tax treatment generally granted Individual Retirement Accounts?

Our initial review of this concept indicates that while it can be structurally designed to qualify for favorable tax treatment, it does not neatly fit into an existing definition.

It is our opinion that the best course of action for the State to pursue would be outreach to the Department of Labor (on ERISA) and the IRS to pursue codification for CSC. This may also require federal legislation. We have seen other states demonstrate interest in establishing similar programs like CSC, and think that there is momentum available to garner support for these exemptions.

One aspect of gaining exemptions from legislation like ERISA is the public perception it may create—that CSC would not possess important protections afforded by federal legislation. To overcome this, CSC must create a structure that demonstrates that the State of California has strong oversight over the Program and any vendors associated with it. Moreover, it must endeavor to select a vendor that has a strong record of success and exemplary conduct in the marketplace to reassure the millions who will participate in CSC.

19. What further statutes and/or regulations would you recommend be enacted in order to strengthen the legal basis for this retirement savings Program?

Additional statutes and regulations may be required, but we recommend that the enactment of such be based upon experience dealing with the aforementioned federal issues.

Establishing a Retirement Investments Clearinghouse

S.B. 1234 grants the Board the authority to establish an online clearinghouse, and to register for inclusion on the website, vendors who offer employer-sponsored retirement plans and payroll deduction plans and who meet specified requirements. The cost of establishing the registration process and the online clearinghouse would be borne equally by registered vendors.

20. Please provide your assessment as to whether there would, or would not, be sufficient interest from vendors to establish an online Retirement Investments Clearinghouse.

To the extent that the cost of such a clearinghouse is not prohibitive to vendors, we anticipate many might be interested in participating as a means of marketing themselves. To some extent, interest may be driven by reaching some critical mass of interest, i.e., if vendors see the clearinghouse participants being numerous enough that not participating is a competitive disadvantage.

The CSC Board can look to existing informational tools already in place in California to determine their efficacy relative to the clearinghouse concept. For example, STRS has a “403(b) Compare” website in which all vendors selling products in the Public K-12 and community college market must register and provide costs and other aspects about their products. This site includes approximately 7000 investment choices across some 75 vendors. There are many publicly available studies that conclude providing investors too many choices, in fact, inhibits people from making informed choices or choosing to invest at all. The Board should seek an approach that can support efficient decision making, perhaps through a process that streamlines the number of vendors and their offerings. It should also be noted that the establishment of the clearinghouse, if it causes CSC to be spread across multiple firms, might dilute the economic attractiveness of administering CSC to a prospective vendor(s).

21. How would you recommend the Board establish a process to register participants and operate the clearinghouse effectively, efficiently, and in a manner that eliminates or reduces any liability on the part of the Board associated with registering participants and operating the clearinghouse?

It would be critical for the Board to establish very clear standards for inclusion in the clearinghouse. One approach the Board may wish to consider is including an existing industry entity like an SRO (self-regulating organization) in the process.

Developing the Request for Proposal (RFP) for the Market Research, Plan Design and Feasibility Study

22. Do you have any recommendations for the type of firm, or firms, that would be most qualified and able to conduct the work necessary for the market research, feasibility and plan design study?

Due to possible conflicts with our ability to propose on future business, TIAA-CREF respectfully prefers not to make recommendations in this area.

23. Are there firms that would be able to successfully conduct all aspects of the work, or is it likely the Board will have to contract with more than one firm?

There may be firms that possess the capability to conduct all aspects of this work.

24. Do you have recommendations about requirements that should be included in the RFP either in terms of the scope of work required or the qualifications of bidders?

Due to possible conflicts with our ability to propose on future business, TIAA-CREF respectfully prefers not to make recommendations in this area.

Disclosures

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